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Report of the Auditor General of Canada to the House of Commons

Chapter 18
Governance of Crown Corporations

December 2000

This December 2000 Report comprises 18 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, October and December 2000 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 18

Governance of Crown Corporations

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Governance of Crown Corporations

Main Points

18.1 The management of Crown corporations has improved since the *Financial Administration Act* was amended in 1984 to strengthen their control and accountability framework. Nevertheless, further improvement is needed in some important areas like strategic and corporate planning and the measurement and reporting of performance. We found a need for special attention in three areas that are central to the way Crown corporations are governed:

- Boards of directors of Crown corporations need to be strengthened. They reflect Canada's diversity but lack other key skills and capabilities that are needed to function effectively and to carry out their important responsibilities under the *Financial Administration Act* for the affairs of the corporation. Corporations need to better define their requirements for skills and capabilities and communicate them to the government; the government needs to act on those requirements. Boards of directors also need to be more engaged in the selection of their chair as well as the corporation's chief executive officer (CEO). Without meaningful board involvement in the selection of the chief executive officer, his or her accountability to the board is weakened and corporate governance as a whole suffers.
- Audit committees in Crown corporations play a crucial role in financial reporting, risk management, and internal control. They are the "engine" of the board of directors. Yet half of the audit committees we examined were operating below an effective level. Serious weaknesses in an audit committee can undermine the overall strength of the board.
- The government has a limited capacity for reviewing and challenging Crown corporation corporate plans as a basis for approving them. Corporate plans set out the strategic direction of a Crown corporation and are intended to be the cornerstone of the Crown corporation control and accountability framework under the *Financial Administration Act*. The government needs to strengthen its capacity to review and challenge these plans since, once approved, they are the basis for holding Crown corporations accountable for conforming to government policy and for their overall performance. Furthermore, there is a need for a more systematic and regular review of the relevance of Crown corporation mandates.

18.2 Weaknesses in all of these areas impede the successful implementation of Part X of the *Financial Administration Act* and the quality of Crown corporation governance. They have been raised many times before, in Auditor General reports and other external studies and reports, but the weaknesses remain. Crown corporation CEOs and chairs view the resolution of these issues as critical and they need to be addressed with urgency. Other industrialized countries have moved ahead of Canada in these areas of Crown corporation governance.

18.3 Corporate governance refers to the process and structure for overseeing the direction and management of a corporation so that it carries out its mandate and objectives effectively. It is critical that a Crown corporation, as a public sector body, be governed well if taxpayers' money is to be well spent. Good corporate governance is important to maximize performance, prevent financial losses and help to achieve the corporate mandate. But it is in times of difficulty, turbulence and change that good governance is most critical.

Background and other observations

18.4 Crown corporations are distinct legal entities wholly owned by the government. They operate in many sectors, including transportation, agriculture and culture. They have more autonomy to manage than most other

government entities so they can operate in a more commercial manner. A board of directors oversees the management of each corporation and holds management responsible for the corporation's performance. The government retains power and influence over Crown corporations in areas like appointments, remuneration for chief executive officers and directors, and approval of plans and budgets.

18.5 Crown corporations account for a significant portion of government activity. There are currently 41 federal Crown corporations (not including subsidiaries), employing 70,000 people. In aggregate (excluding the Bank of Canada), they manage $68 billion in assets and $61 billion in liabilities. While Crown corporations represent a significant opportunity to achieve public policy and other goals and to generate revenue, they also represent significant exposure to potential financial losses and other risks.

18.6 In addition to our continuing work as auditors and examiners of most Crown corporations, we looked in detail at a representative group of 15 Crown corporations. We also compared Canadian Crown corporations with state-owned enterprises elsewhere, and used the results of other research, studies, audits and roundtables to support our findings. In addition, we summarized the results of special examinations — a type of value-for-money audit of Crown corporations — carried out between 1984 and 2000.

In view of the fact that many of the recommendations deal with Governor in Council discretion, no detailed responses to the recommendations were made. Overall, the Privy Council Office states that the government has made strides in a number of corporate governance areas, and is committed to examining measures to address areas needing improvement and to ultimately strengthening governance in Crown corporations. The Privy Council Office also states that it is paramount to ensure that appointments to Crown corporations result in strong boards of directors, and that the appointment process for Crown corporations be inclusive of all interested parties, bearing in mind that appointments remain at the discretion of the government.

Reaction from Crown corporation chairs and CEOs indicate that, for the most part, they agree with the recommendations directed specifically at them.

Introduction

18.7 Crown corporations are distinct legal entities that are wholly owned by the government. Their use by government to deliver important public programs dates back to Confederation; they operate in many sectors of the Canadian economy, including transportation, energy and resources, agriculture and fisheries, financial services, culture, and government services. Crown corporations vary widely in size and in the level of financial support they receive from the government.

18.8 Crown corporations account for a significant portion of the government's activity. There are currently 41 Crown corporations (excluding subsidiaries), employing 70,000 people. In aggregate (excluding the Bank of Canada), they manage $68 billion in assets and $61 billion in liabilities. While Crown corporations represent a significant opportunity to achieve public policy and other goals and to generate revenue, they also represent significant exposure to potential financial losses and other risks. They have total debt obligations (debts payable to Canada and to the private sector) of $49 billion. Government budgetary appropriations are $3.8 billion annually. Appendix A presents a list of all Crown corporations (excluding subsidiaries) by ministerial portfolio.

Crown corporations account for a significant portion of the government's assets, liabilities and expenditures.

Major legislative reforms of Crown corporation governance in 1984

18.9 The *Financial Administration Act (FAA)* was amended in 1984 to address major performance problems in Crown corporations. The amendments to the *FAA* (Part X) imposed a more rigorous regime, designed to ensure an adequate level of direction, control and accountability of Crown corporations. All Crown corporations fall under the *FAA*, except for some "exempt" corporations where Parliament agreed to create further distance from the government.

18.10 The new regime created a unique model for governance, establishing the relationship that should exist among a Crown corporation, the responsible minister, the government and Parliament. The regime outlines the roles and authorities of the corporation's board of directors, management, the responsible minister, the Minister of Finance, the Treasury Board, the Governor in Council, Parliament, and external and internal auditors (see Appendix B for details).

18.11 The regime attempts to balance the Crown corporation's relationship with the government between its "arm's length" independence in day-to-day activities and government's appropriate direction and control. Crown corporations have more autonomy to manage than most other government entities so they can operate in a more commercial environment. A board of directors oversees the management of each corporation and holds management responsible for the company's performance. Through the Crown corporation's chair, the board of directors is accountable to a minister who represents the government and acts as the link between the corporation and both Cabinet and Parliament. The government retains power and influence over Crown corporations in areas like appointment and remuneration of directors and chief executive officers, directives and regulations, and approval of corporate plans and budgets. Each Crown corporation is accountable to Parliament through the responsible minister.

Crown corporations have more autonomy to manage than most other government entities.

18.12 The *FAA* amendments also strengthened internal audit and introduced special examinations (a type of value-for-money audit) in most Crown corporations, in addition to the annual audits of financial statements. Special examinations provide the board with an independent opinion on how well the corporation is being managed. A Crown corporation must undergo a special examination every five years; the

period 1996 to 2001 represents the third cycle of special examinations since the *FAA* was amended. Appendix C outlines the role of special examinations and provides more detail on what they examine. It also presents an overall summary of findings over the three examination cycles to date.

18.13 Each Crown corporation's enabling legislation, whether a special act of Parliament or articles of incorporation under the *Canada Business Corporations Act*, sets out in broad terms its mandate, powers and objectives.

Good corporate governance is more important than ever

18.14 Like most organizations, Crown corporations face a complex and rapidly changing environment. The private sector is increasingly active in areas that once were the exclusive domain of Crown corporations. Technological advances and consumer demands for new and different services create pressure for change.

Research shows a relationship between good governance and good results.

18.15 Crown corporations must deal with the added complexity of managing in the public sector. Corporations in the private sector operate to maximize shareholder value. However, the objectives of Crown corporations are not always that clear. Many are required to achieve financial self-sufficiency while meeting public policy objectives (such as delivering needed services that are not commercially viable).

18.16 Corporate governance refers to the process and structure for overseeing the direction and management of a corporation so that it carries out its mandate and objectives effectively. It is critical that a Crown corporation, as a public sector body, be governed well if taxpayers' money is to be well spent.

18.17 Good corporate governance is essential if a Crown corporation is to fulfil its mandate. In good times, good governance can increase the effectiveness of performance and help to prevent potential financial losses, ineffectiveness and inefficiencies. But it is in times of difficulty, turbulence and change that good governance is most critical.

18.18 In the recent past, landmark studies (for example, the Cadbury Report, United Kingdom 1992, Gérard Veilleux's report "Unfinished Business" in 1993, and the 1994 Toronto Stock Exchange Guidelines for Improved Corporate Governance in Canada) have focussed on the need to address gaps in corporate governance. Corporate failures and scandals have been linked to weaknesses in governance. The Canadian Institute of Chartered Accountants, supported by the Toronto Stock Exchange and the Canadian Venture Exchange, has established a Joint Committee on Corporate Governance to review the current state of corporate governance in Canada, compare Canadian practices with international best practices, and recommend changes to ensure that Canadian corporate governance is among the best in the world. It has become an accepted reality for private and public sector corporations that good governance is essential to long-term success.

18.19 The literature shows a relationship between good governance and good results. For example, companies whose standards of corporate governance are high are more likely to gain the confidence of investors and support for the development of their businesses.

Focus of the audit

18.20 Our special examinations over the last 15 years indicate that overall the management of Crown corporations has improved since the *FAA* was amended. Nevertheless, further improvement is needed in some important areas like strategic and corporate planning and the measurement and reporting of corporate performance.

18.21 Government documents, important studies, professional literature and the accountability and control regime

for Crown corporations all point to the fundamental importance of effective corporate governance. However, our experience with auditing Crown corporations suggests a need for special attention to three areas that are central to the governance of Crown corporations:

- the process of appointing the chief executive officer (CEO) and the board chair and directors;

- the composition, role, responsibilities, and performance of the board's audit committee; and

- the government's capacity to review and challenge the corporation's corporate plan before approval and to ensure that Crown corporation mandates continue to be relevant.

18.22 Weaknesses in these three areas impede the successful implementation of Part X of the *FAA* and the effective governance of Crown corporations. Previous reports of the Auditor General have raised the need to resolve them, as have studies and reports by others, but the weaknesses remain. This chapter discusses them in detail. Crown corporation CEOs and board chairs cite as an ongoing frustration these continuing weaknesses in areas they view as high priorities. Other countries have moved ahead of Canada in these areas of Crown corporation governance.

18.23 Given their importance to good governance of Crown corporations and the concerns identified during the course of our previous audits, these three areas were the focus of this audit. We set out to examine how well these areas were now functioning. The audit scope included key provisions of Part X of the *FAA* and parallel provisions in the enabling legislation of Crown corporations exempted from Part X. Further details on the audit scope, objectives and criteria are presented at the end of the chapter in **About the Audit**.

Observations and Recommendations

Appointing Boards of Directors, Board Chairs, and Chief Executive Officers

Boards of directors have a pivotal role

18.24 The government has stated, "...Crown corporations will operate at peak efficiency only when boards of directors operate at peak efficiency" (Crown Corporations Direction, Control, Accountability, Government of Canada's Proposals, Privy Council Office, 1977). The *FAA* stipulates that the board of directors is responsible for the affairs of the corporation. The Treasury Board's guidelines on Corporate Governance in Crown Corporations and Other Public Enterprises (1996) include a number of ways to strengthen the board's effectiveness. The guidelines state that a board of directors has a duty to oversee the management of its Crown corporation with a view to both the best interests of the corporation and the long-term interests of the government. To fulfil that stewardship duty, the board is expected to exercise judgment in establishing the corporation's strategic direction, safeguarding the corporation's resources, monitoring corporate performance, and reporting to the Crown. The board is accountable for its performance to the responsible minister, and the minister is accountable in turn to Parliament for the performance of the corporation.

18.25 It is therefore in the government's interest to appoint strong boards of directors. The appointment of directors is a fundamental prerogative of the shareholder in private sector and public sector corporations, including Crown corporations. Under the *FAA*, the responsible minister appoints directors with the approval of the Governor in Council, following a review of the minister's recommendations by the Prime

It is in the government's interest to appoint strong boards of directors to oversee the management of Crown corporations.

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Minister's Office. The government needs to appoint strong boards, allow them to do their work, and dismiss those that do not. Given the pivotal role of the board of directors in governing a Crown corporation, we looked for timely appointments of qualified directors who met the requirements of both the government and the corporation.

Boards reflect Canada's diversity but lack other key skills and capabilities

Many chairs and CEOs are not satisfied with the mix of skills and capabilities on their boards.

18.26 The first step in any effective appointment process is to identify the skills and capabilities the position requires. The government has made a commitment to appoint, on the basis of competence and equity, directors who meet the following requirements:

- Appointees must meet the criteria that may be specified in the corporation's particular enabling legislation.
- Geographic regions must be well represented on the board and geographic concerns taken into account.
- The capacity to speak both official languages is often required.
- Persons appointed will better represent women, visible minorities, Aboriginal peoples, and people with disabilities (So You Want An Order-In-Council Appointment? by Penny Collenette, Prime Minister's Office).

18.27 The government has improved the gender balance and geographic representation on boards of directors. According to the Conference Board of Canada, Crown corporation boards continue to lead all sectors in board gender balance, with women accounting for 30 percent of directors, compared with 10 percent in other sectors; and 18 percent of board chairs are women, compared with 6 percent in other sectors. Sixty-five percent of Crown corporations view geographic representation as the top criterion in the selection of new board directors, compared with 25 percent of private sector corporations.

18.28 Many Crown corporation chairs and CEOs report that they are not satisfied with the mix of skills and capabilities on their boards. According to the Conference Board of Canada, 18 percent of Crown corporations view a specific skill set to complement the board as the top criterion in the selection of new board directors, compared with 58 percent of private sector corporations. When we asked Crown corporation chairs and CEOs what necessary capabilities or skills their boards of directors were missing, they noted gaps in one or more of financial expertise and financial literacy, marketing, accounting, strategic leadership, previous experience on a board of directors or related experience, ideally in an organization of similar stature (assets, revenues, complexity), and knowledge of the corporation's business. They also noted the value of having a chair or one or more

Exhibit 18.1

Comments on Board Skills and Capabilities by Chairs and CEOs

"Politics, gender and geography are the top three selection criteria now....Relevant business experience needs to be number one."

"Twenty-five percent of the board today are out of their depth due to political criteria being used [for selection] instead of business."

"Depth of experience is needed, and character to promote a close working relationship with the CEO."

"Experience in specific industries (for example, financial services) is essential to the board, but ignored in recent appointments."

"We have lots of lawyers, which is fine, but could use at least one accountant."

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directors with previous CEO experience. Exhibit 18.1 presents some of their comments.

18.29 We also asked chairs and CEOs about the impact of these gaps in skills. Their responses indicate that the gaps undermine the board's effectiveness. For example:

> Today, the only individual on our board who has a strong financial background is the CEO....How can the board direct, oversee or even support the corporation's work effectively?
>
> CEOs look to the board, and individual directors, to run ideas by, and to engage in in-depth exploration....This role of the board can't be fulfilled now.

18.30 These gaps in board skills and capabilities are a reflection of the appointment process, which we examined in some depth. The selection process for board directors must seek out people with the capabilities and skills that are essential to the effective functioning of the board; that is in the interest of both the government and the Crown corporation. The government needs to understand the skills and capabilities the corporation needs and lacks on the board when it looks for candidates to fill board vacancies. At the same time, it also needs to meet its own objectives. The final appointment must reflect the needs of both the government and the corporation.

Gaps in skills and capabilities undermine the board's effectiveness.

Appointments need to meet the board's skill and capability requirements

18.31 Both the government and the Crown corporation have a role to play in ensuring that directors have the necessary qualifications to meet the board's needs. Under the *FAA*, the responsible minister appoints the board of directors with the approval of the Governor in Council. That the "board of directors should contribute to its own renewal" is also clearly stated in the Treasury Board's guidelines on corporate governance:

> The selection and recruitment of knowledgeable and skilled candidates to the board is of prime importance...Recommendations by the existing board influence the selection and approval process. The board's experience...provides an ideal basis for the board to review the suitability of its composition and the effectiveness of its performance.... The board's self-assessment of the skills required can be a useful basis for recommendations on the appointment or replacement of directors as terms approach expiry. The chair, on behalf of the board, should advise the appropriate minister and the Director of Appointments in the Prime Minister's Office of the desired mix of skills useful for the board and, in particular, those skills that should be sought in upcoming vacancies.

18.32 Consistent with best practices, boards need to produce profiles that specify the skills they require based on identified needs or gaps, and that focus on the positions themselves rather than the individuals who might fill them. The board profiles must capture the skills the corporation will need in the future to move its strategic direction forward. In his 1993 report, Gérard Veilleux recommended the use of board profiles in Crown corporations. The Privy Council Office, the Treasury Board, the Auditor General, and several provincial governments endorsed the recommendation.

Only 34 percent of Crown corporations have completed profiles outlining their requirements for director skills and capabilities.

18.33 And yet we found that many boards of directors have not developed such profiles. In 1995, we reported that 13 percent of Crown corporations were using board profiles and we encouraged ministers to lend their support to the practice. We find now that 34 percent of all corporations have completed profiles or selection criteria for board members. Typically, the Crown corporation sends these to the minister's office, and only

sometimes to the Privy Council Office or the Prime Minister's Office.

18.34 Job descriptions for the board of directors, the chair and the CEO can provide a good context for developing the board skills profile. The corporations that have prepared job descriptions have found them very useful. For example, the process itself builds a shared understanding and communication among the players on their respective roles, and the job description helps to outline the nature of the commitment expected when recruiting or orienting new board directors.

Where the government acted on board skills profiles, the appointment better met the board's needs.

18.35 Fewer than half the corporations that do use board skill profiles have found them effective in the selection of directors. Many reported that while they can and do suggest what they need in future appointments, they have no assurance that the government takes their suggestions seriously; many said that the government has not used their profiles at all.

18.36 We reviewed a sample of board appointments to better understand the process. At one extreme, the government made the appointment after consulting only nominally with the board chairman, or not at all. In many cases, the corporations had prepared skills profiles but found that the government did not use them.

18.37 At the other extreme, the corporation's board of directors conducted the search and recruitment and recommended a single name to the government for approval. In some of these cases, the chair vetted the list of potential candidates for those who met the shareholder's requirements.

18.38 In between these two extremes, the government led the search and actively consulted with the board. The corporations developed board profiles that they believed the government used. In these cases, the chair had a good relationship with the minister, a factor that appeared to smooth the appointment process.

18.39 We found that meetings between the key players were also valuable in communicating the board's desired mix of skills and capabilities that should be sought in filling upcoming vacancies. For example, some board chairs took the initiative to meet with the Prime Minister's Office and the Privy Council Office in advance of a board vacancy to discuss the needs of the board, in keeping with the Treasury Board guidelines.

18.40 Overall, we found that where the government acted on the board's profiles and stated requirements, the appointment better met the board's needs. For example, in some situations the minister sent the resumés of possible candidates to the corporation for consideration and acted on the corporation's assessment of them when selecting board directors. Too often, however, the corporation had not assessed its requirements for skills and capabilities and the government did not consult the board, which led to frustration, unmet needs, and a weakened board.

18.41 Other industrialized countries are ahead of Canada in their practices of appointing board directors. In New Zealand, for example, the objective in selecting directors is to ensure that the board has the necessary skills to enhance the corporation's performance and the interaction and operations of the board, and to ensure that the appointment is consistent with the corporation's strategic direction and its needs. The process reinforces the minister's role in identifying the skills needed in a particular position on a Crown corporation board, appointing a suitable candidate, and reviewing the performance of the directors and the board. It begins with agreement between the minister and the corporation on a board skills profile and it ends with the appointment of the selected candidate, after consultation and/or interviews with the corporation, the

responsible minister and the Minister of Finance. This is followed by the induction of the appointee. New Zealand publishes an outline of the key competencies required in directors. For example, preference is given to candidates who have experience in one or more of the following:

- governance in a significant organization with a commercial focus;
- chief executive or senior management positions in an organization with commercial attributes;
- senior positions in relevant professional disciplines, such as science, technology, finance, law, health, agriculture, and social policy; and
- related governance or management positions in community or professional organizations.

18.42 The United Kingdom has a Commissioner for Public Appointments, whose objective is to manage an appointment process that will merit the confidence of candidates and the public. The government requires that the process be efficient, transparent, and based on merit. The process incorporates a number of procedures and principles such as scrutiny by an independent assessor, transparency and openness, and proportionality (which means the appointment process is appropriate to the nature of the post and the magnitude of its responsibilities). All stages of the process are subject to audit. No one is appointed to a public body without some form of interview, and candidates must answer a question about their political activities, to provide transparency and to identify related skills and experience that could be useful and that may demonstrate commitment. The government states that political activity and affiliation are normally not criteria for appointment.

18.43 Two recently created Crown corporations in Canada have adopted the practice of appointing a nominating committee to identify director candidates, a model that could be used more widely.

18.44 Each Crown corporation should develop a board skills profile. The chair, on behalf of the board, should communicate the profile to the responsible minister, the Privy Council Office and the Prime Minister's Office, as well as the board's specific skills and capability requirements for upcoming vacancies. The government should act on these stated requirements in its selection of directors.

18.45 Each responsible minister and the corporation should reach an understanding on how the board will be engaged in the selection and appointment of directors.

A need to maintain continuity and experience on boards of directors

18.46 We analyzed appointments made to 15 Crown corporation boards from 1996 through 2000. We drew our data from appointment guides published by the Privy Council Office, outlining the terms and conditions for all appointments approved by the Governor in Council.

More directors are serving on Crown corporation boards for longer periods.

18.47 The *FAA* states that directors can be appointed to terms of up to three years, and reappointed if desired. It provides for directors to continue serving after their terms have expired until either they are reappointed or a new appointment is made. This provision ensures that boards can continue to function, even if there are delays in the appointment process.

18.48 The length of time directors serve is improving, but still too short. Most directors of Crown corporations are appointed to the maximum three-year term allowed for by the *FAA*, although there have been some terms of one and two years. The biggest factor in the length of time a director serves on the board is not the length of the term but rather the number of reappointments. There are positive signs that indicate some

improvement. More directors are serving on Crown corporation boards for longer periods, which means that the number of reappointments is increasing. Sixty-four percent of incumbents eligible for reappointment have been reappointed for at least a second term. This higher rate of reappointment has helped to increase the average duration of service by directors, from 3.9 years in 1997 to 4.6 years in 2000. However, length of service still lags behind the private sector where, according to the Conference Board of Canada, directors serve an average of 7.7 years.

18.49 Appointment decisions are not timely. Crown corporations report that a serious problem impacting on board continuity and stability is the length of time it takes to decide on many appointments. The amount of time from the date a director's term expires to the date of reappointment or appointment of a new director is called the "expired period."

There is a need for better director training.

18.50 We examined 79 appointments whose terms had expired over the last five years. While in 2000 the average expired period was five months, in 70 percent of the corporations in our sample it was longer than six months — and longer than a year in half of them. In one Crown corporation, 80 percent of the directors have continued in expired positions for over a year, and the chair position is vacant.

18.51 Appointment terms are unevenly staggered. In 6 of the 15 Crown corporations in our sample, the current terms of more than 50 percent of the board directors will expire in a single year — and as many as 80 percent in two corporations. The *FAA* requires that as far as possible no more than 50 percent of a board's director positions should expire in any one year. Coupled with the slow process of deciding on appointments, this kind of turnover leaves many boards with considerable uncertainty about their composition. Expiry dates need to be staggered evenly to ensure that continuity of expertise and corporate memory is not compromised.

18.52 The government should decide on Crown corporation director appointments on a timely basis, improve the staggering of term expiry dates and increase the length of service of qualified directors.

Other factors affect board functioning

18.53 Past reports of the Auditor General have observed that new directors were not adequately briefed on their duties. Despite some improvement, the situation today is similar. Crown corporations generally provide orientation sessions for new directors, and some urge their directors to attend external training sessions. However, there is a need for training in the director's responsibilities to the corporation, the corporation's relationship with the government, compensation policies for Crown corporation executives, and board procedures. There is a need to professionalize the role of directors, many of whom have had no previous experience on boards of any kind.

18.54 The government, with Crown corporations, should ensure that newly appointed directors are provided with adequate orientation and training in their responsibilities to the corporation, the corporation's relationship with the government, compensation policies for Crown corporation executives, and board procedures.

18.55 Senior government officials and some Crown corporations have raised questions and concerns about the appointment of public servants, particularly deputy ministers of federal government departments, to boards of directors of Crown corporations. These appointments pose particular challenges for the individuals as well as for the boards on which they serve. The Treasury Board guidelines point out that the

knowledge and expertise of deputy ministers can assist the board in better appreciating government policy. Similarly, participation as a member of the board of directors improves the deputy minister's understanding of the corporation. Crown corporations have raised other issues about public servants on their boards of directors, including attendance records (particularly for deputy ministers), a concern that some boards include too many public servants, and a practice by some deputy ministers of periodically sending a substitute to a board meeting. The deputy minister sits on the board not as a source of direction from the minister but with the same statutory obligations as other directors. Yet some corporations report that other directors sometimes defer to the deputy minister because they believe he or she is a direct spokesperson for the government. Some are also concerned about the potential for conflict between the individual's dual roles as director and as deputy minister. It is important that deputy ministers be particularly sensitive to these issues. The role and attendance of public servants on Crown corporation boards of directors needs ongoing, close monitoring.

Chair appointments often made with limited board consultation

18.56 The chair of a Crown corporation acts as the formal link between the minister and the corporation. The chair manages the affairs of the board of directors and is not a part of the corporation's management.

18.57 Under the *FAA*, the Governor in Council has the authority to appoint and fire the chair, and to fix the compensation. The Act also provides for the board to influence the appointment, through a provision that requires the responsible minister to consult with it. The chairs, CEOs and directors we interviewed said that the board needs to play an active role in the chair's appointment, including assessing board needs and profiling skills. We expected to find that the government consulted meaningfully with the board as a whole.

18.58 Many of the corporations in our sample report that there has been limited consultation with the board, if any, on the selection and appointment of the chair.

18.59 The government should ensure that it consults with boards of directors of Crown corporations on chair selection and appointment.

Appointment of the chief executive officer is a key factor in corporate governance

18.60 The key to good management of a corporation is the chief executive officer (CEO). The *FAA* gives the Governor in Council the authority to appoint and fire the CEO and to fix remuneration. The Act also provides for the board to influence the CEO's appointment, in requiring that the responsible minister consult with the board. The board has the authority to evaluate the CEO's performance.

There must be a clear accountability relationship between the CEO and the board.

18.61 The Treasury Board guidelines on corporate governance in Crown corporations stress the importance of the relationship between the CEO and the board:

> In a Crown corporation, the nature of the relationship between the CEO and the board is often critical. The board must work with the CEO to build a relationship of openness and trust.... An important aspect...is to establish a clear accountability relationship for the CEO to the board....

18.62 In the private sector, this accountability relationship is achieved by virtue of the board's power to hire and fire the CEO and fix remuneration. Those powers are critical to good governance in any corporation. But some have pointed to an accountability dilemma in Crown corporations. After far-reaching consultation and research, the Public Policy Forum's 1998 study concluded, "The lack of hire, fire and pay powers

over the president deprives Crown boards of the most powerful accountability lever exercised by private sector boards." The Public Policy Forum report added that many Crown corporation CEOs do not feel accountable to their boards. It said, "Many Crown presidents, while paying lip service to the valuable advice they receive from their boards, are quite candid in seeing that their essential accountability lies with the government and particularly with those at the centre of it."

Many Crown corporation CEOs are quite candid in seeing that their essential accountability lies with the government and not with the board.

18.63 Research by the Conference Board of Canada indicates that 90 percent of Crown corporations hold the view that boards must be involved in the final selection of the CEO. This is perceived as the most significant issue in Crown corporation governance. Asked what one thing they would change in the selection and appointment process, Crown corporations overwhelmingly said they would increase the board's involvement in the selection of directors and the CEO.

18.64 In our view, the CEO appointment process ought to be measured by more than the strength of the CEO selected. The appointment also needs to reinforce the CEO's accountability relationship with the board, while preserving the appointment prerogative of the Governor in Council. For example, if a strong CEO is selected but the chair and the board lack confidence in the process that led to that selection, then the single most important relationship in the corporation — between the chair and the CEO — can begin with doubts and a lack of trust.

18.65 We noted the use of three different models in recent appointments of CEOs to Canada's Crown corporations. The models varied in approach, as did the way each applied the requirement for "consultation with the board":

- **"Centre selects" model.** The identifying feature of this model was that the government not only controlled the search for the new CEO but also made the selection without meaningful consultation and buy-in from the board and the chair. In effect, the corporation was told who the CEO would be.

- **"Centre searches" model.** In this model, the government ran the CEO search and recruitment process, but made the selection only after meaningful consultation with and buy-in from the chair as proxy for the board. The chair was a member of the search committee, along with representatives of the Privy Council Office (PCO), the Prime Minister's Office (PMO) and the responsible minister. The search committee established the selection criteria, in some cases using the board's input, and conducted the interviews. The board had no direct role, but in some cases the chair went back to the board for input on the shortlist of candidates. The PMO advertised the position and accepted candidates' applications. The search committee conducted the initial screening of applicants. The PMO confirmed the selection of the candidate recommended by the search committee.

- **"Board searches" model.** Under this model, the Crown corporation led the CEO search process through either a search committee or the board. The board asked the PCO and the PMO to suggest any additional candidates, and recommended a shortlist to the government. Candidates were interviewed by the board and then by the minister. The government made the final selection of the CEO.

18.66 The literature and best practices show conclusively that active and independent board governance leads to stronger corporate performance. When the board has no meaningful involvement in the selection of the CEO, problems of accountability can arise between them. In many industrialized countries, boards play a leading role in the search for their CEO, not just in private sector firms but in

state-owned enterprises that are comparable with Crown corporations.

18.67 Our interviews with a sample of chairs, CEOs and directors of the Crown corporations involved in the three CEO appointment models we have described confirmed that they strongly and consistently favour a greater role for the board in the CEO search and selection process. They rated the three appointment models in terms of governance effectiveness.

"Centre selects" model found least favour

18.68 The Crown corporation leaders we interviewed, including (perhaps surprisingly) the CEOs themselves, rated the "centre selects" model the worst of the three by far. It is also the model furthest from good governance practices. Chairs and directors whose CEO was selected by the "centre selects" model said unequivocally that the exclusion of their chair and board members in the CEO's selection had led to serious governance problems.

18.69 CEOs selected by this process quickly understand that their true accountability is to the government and not to their board. They acknowledge that they gain access and influence with the centre of government when the government alone drives the selection process. However, this very access compromises the board's capacity to govern. Lack of government consultation with the board on the CEO selection often amounts to lack of buy-in and the creation of a rift between the board and the CEO before he or she even takes office. Our interviews with Crown corporation leaders indicate that the CEO must perceive that the board has real power and is leading the selection process if the accountability relationship between the CEO and the board is to be effective.

"Centre searches" model got mixed reviews

18.70 Some see the "centre searches" as the new model for CEO selection. However, while board chairs and the government viewed it favourably, we found that CEOs and directors were less supportive. The model has some definite strengths. The board chair is on the search committee along with the other key players — the Prime Minister's Office, the minister's office, and the Privy Council Office; the PCO and the PMO have solid experience in carrying out a search process. This model also helps to build relationships among the players.

18.71 The model has some fundamental weaknesses, however. First, board directors state that they have had no meaningful involvement in the CEO's selection under this model. The Crown corporation's involvement through the chair as sole proxy, while an improvement over the "centre selects" model, is still limited. This model does not effectively engage the board as a whole in the search process. As a result, the board may be less committed to the selected candidate. Second — and this is key — the candidates see that the PCO, the PMO and the minister's office dominate the process: they advertise for candidates and candidates respond to them. Third, three of the four participants on the search committee represent the government, giving it the balance of power in selecting the candidate. Overall, the "centre searches" model does not go far enough and we would view it as a transitional model.

CEOs, chairs and directors see the "board searches" model as supporting good governance.

"Board searches" model seen as the most effective

18.72 The model rated the most effective by chairs, CEOs and directors was the "board searches" model. That they see it as supporting good governance and a strong accountability relationship between the board and the CEO is clear from the following comments:

> It worked, it included all levels in the process....
>
> If the board is to fulfil its mandate, it must be given a major role in CEO recruitment.
>
> Excellent model not only in terms of the result but also for board buy-in and the support of the new CEO. The most important role of a board is to hire, retain, evaluate and compensate the CEO — often taken out of our hands by the shareholder.

The government needs to move toward a process in which the Governor in Council selects the CEO from board-recommended candidates.

18.73 The "board searches" model is the most consistent with best practices in comparable organizations. Also, chairs, CEOs and directors have reported strong mutual trust and respect among all corporate players and with the government when this model is used.

18.74 The enabling legislation of some Crown corporations includes a "board searches" model. It gives the corporation the statutory authority to appoint the chief executive officer, with the approval of the Governor in Council.

A transition strategy may be necessary

18.75 It has been argued that at present, some Crown corporation boards are not strong enough to conduct the search for a CEO along the lines of the "board searches" model. We recognize that many boards lack key capabilities and, as a result, difficulties have sometimes developed when the "board searches" model has been used. In our view, the solution is for the government to move toward a "board searches" model in which the Governor in Council selects the CEO from a slate of board-recommended candidates as the government undertakes to strengthen Crown corporation boards.

18.76 The move to a "board searches" model calls for a transitional strategy that could be adapted to meet the particular needs of each Crown corporation. The extent of government support and involvement or external expertise could vary, depending on a board's capability at any given time; an interim approach could be used to involve the board more directly as it develops the capacity to carry out a "board searches" model. For example, the "centre searches" model could be adapted to include members of the board's search committee along with the chair and representatives of the PMO, the PCO, and the minister's office. Or a committee of the board could interview and make recommendations on a shortlist of candidates selected by the chair, the PMO, the PCO, and the minister's representative. In addition, boards may require some training in how to conduct an effective CEO search process.

18.77 The government remains ultimately accountable for the performance of a Crown corporation, and the *FAA* gives the Governor in Council the authority to appoint, fire and remunerate the CEO. None of this changes with a "board searches" model; the difference lies in who is seen by candidates and the corporation to be leading the process. The government would need to work closely with the corporation and remain directly involved at each stage of the process, contributing selection criteria, for instance, and suggesting potential candidates.

18.78 The board of directors of a Crown corporation, in direct consultation with the minister, the Prime Minister's Office and the Privy Council Office, should lead the process of selecting the corporation's chief executive officer for approval by the Governor in Council. A transition strategy should be used where a board does not yet have the capability to carry out this approach.

18.79 In each case, the responsible minister, the Crown corporation, the Prime Minister's Office and the Privy Council Office should reach an understanding on the respective roles of the board and the government in selecting and appointing the CEO.

Importance of the Audit Committee

18.80 The audit committee is a core committee of a corporation's board of directors. It represents the "engine" of a well-functioning board. Given the rapidly increasing scope and importance of its role, the audit committee's effectiveness is attracting greater attention in the corporate world.

18.81 An audit committee that operates effectively can bring significant benefits to the corporation. It can help to:

- improve the quality of financial reporting;
- ensure that key corporate risks are identified and managed adequately;
- strengthen the internal audit function;
- enable the directors to contribute their independent judgment and play a positive role in overseeing the corporation's business operations;
- facilitate better communication among management, directors and internal and external auditors;
- reinforce the independence of the internal and external auditors;
- create a climate of discipline and control that will reduce the opportunity for fraud;
- increase stakeholder confidence in the credibility and objectivity of corporate performance reports; and
- obtain greater assurance that assets are protected and resources are managed economically, efficiently and effectively.

18.82 The *FAA* specifically charges each parent Crown corporation to establish an audit committee. The committee's legislated responsibilities are to oversee internal audit; review and advise the board of directors on the financial statements, the annual auditor's report and the special examination plan and report; and perform other functions delegated to it by the board. However, the audit committee usually assumes oversight responsibilities well beyond these duties. It is expected to oversee the management of a wide range of financial and non-financial risks that affect the corporation.

An audit committee that operates effectively can bring significant benefits to the corporation.

18.83 We looked at the performance of 14 Crown corporation audit committees. We compared their practices with a dozen recognized best practices (see Exhibit 18.2), to provide a basis for future self-assessment and to identify potential for improvement in their performance. We used a combination of document review and our own observations to assess their effectiveness, given that the Auditor General is the statutory auditor of most Crown corporations (the complete list of best practices is provided in Appendix D).

18.84 We expected that audit committees would have the appropriate skills and experience to carry out their role and their duties effectively. Because the best practices we selected for comparison are viewed as key practices and are consistent with existing *FAA* requirements, we expected that Crown corporations would be using many of them. However, this is not what we found.

Half of the audit committees we examined were considered ineffective or only marginally effective.

Half of the audit committees were operating below an effective level

18.85 Half of the audit committees we examined were considered ineffective or only marginally effective. Of the 14 committees, we found that:

- only one followed most of the best practices and was performing effectively;
- six followed many of the best practices and were reasonably effective;
- five others used only some of the best practices and were only marginally effective; and

Exhibit 18.2

Selected Best Practices for Audit Committees

Audit Committee Responsibilities

The audit committee should ensure financial oversight by:

- critically reviewing the interim and annual financial statements, the auditor's report and the management discussion and analysis section of the annual report; and
- actively soliciting the external auditor's judgments about not only the acceptability but the quality of the corporation's accounting principles as applied in its financial reporting. This discussion should include such issues as the clarity of financial disclosure and the aggressiveness or conservatism of the corporation's accounting principles and estimates.

The audit committee should ensure oversight of corporate books, records, financial and management control and information systems, and management practices by:

- reviewing the special examination plan and report prepared by the external examiner;
- actively soliciting information about significant risks and exposures and reviewing the adequacy of internal controls to manage those risks;
- reviewing the integrity and effectiveness of the management information systems;
- reviewing internal audit plans and reports and management's subsequent actions; and
- reviewing significant findings and recommendations made by the external auditor and examiner and following up on management's subsequent actions.

The audit committee should:

- ensure ethical oversight through the annual review of management's compliance with the corporate code of conduct; and
- actively solicit all sensitive information (for example, senior management expenses, significant litigation, non-compliance with laws and regulations, misuse of corporate assets, illegal activities).

Membership and Competencies

The audit committee should be composed of at least three directors, the majority of whom should not be officers or employees of the corporation.

Although a variety of skills and experience is beneficial to an effective and balanced audit committee, all members should be financially literate and at least one member should have accounting or related financial management expertise. Financial "literacy" signifies the ability to read and understand fundamental financial statements, including a balance sheet, income statement and cash flow statement, and the ability to ask probing questions about the corporation's financial risks and accounting. "Expertise" signifies past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background that results in the individual's financial sophistication (experience as a chief executive officer (CEO), for example, or other senior officer with financial oversight responsibilities).

Operating Procedures

Terms of reference. Audit committees should have clear, written terms of reference and operating procedures that specify the scope of the committee's responsibilities and how it carries them out, including its structure, processes, and membership requirements.

Meetings. The frequency of audit committee meetings should be tailored to the responsibilities assigned, but should be at least quarterly. The audit committee should also meet periodically with management, the external auditor and the head of internal audit, in separate private sessions.

- two were ineffective, despite using some of the best practices.

The results demonstrate that the more best practices an audit committee uses, the more effective it is likely to be.

Key gaps in practices

18.86 Financial literacy and accounting expertise. The competencies and experiences of its members are an important factor in the audit committee's effectiveness. Our assessment raised some important concerns:

- There were three audit committees with at least one member who was not financially literate, and on one audit committee most members were not financially literate. Best practice recommends all members have the ability to read and understand fundamental financial statements and the ability to ask probing questions about the corporation's financial risks and accounting.

- Two audit committees had no members with any accounting or financial management expertise. Best practice recommends at least one member have professional certification in accounting, or experience that leads to financial sophistication — employment as a CEO or senior financial officer, for example.

18.87 Financial oversight responsibilities. A review of committee minutes indicated that audit committees generally follow only some of the best practices for ensuring financial oversight. Only two audit committees were following most of the best practices, including performing a critical review of interim and annual financial statements and the management discussion and analysis section of the annual report, soliciting the external auditor's views on the quality of the corporation's accounting principles, reviewing the external auditor's significant findings and recommendations, and following up on corrective action by management.

18.88 Crown corporation audit committees generally review internal audit plans and reports and the action taken in response to them by management. However, only three audit committees we looked at considered the integrity and effectiveness of management information systems, through brief discussion of corporate performance indicators.

18.89 Operating procedures. The effectiveness of its communications with management and with the internal and external auditors is a factor in the effectiveness of the audit committee itself. Best practices include periodic private meetings with the auditors to give the audit committee a degree of independence from management and a further opportunity to freely ask probing questions. Only four of the audit committees were holding private sessions with the external auditor, and these varied in frequency.

18.90 The audit committee of each Crown corporation should assess the extent to which it follows recognized best practices in order to identify areas that need improvement, and should take appropriate corrective action as necessary. It should seek input to this assessment from the internal audit group and the external auditor.

Approving Corporate Plans and Ensuring Mandate Relevance

The corporate plan is the cornerstone of the control and accountability framework

18.91 The Crown corporation has a key role in interpreting the mandate set out in its enabling legislation. The board of directors oversees the determination of the corporation's core business and activities, its objectives for a five-year period and its strategy for achieving them, and the indicators and targets it will use to measure success. It must determine how it will balance its commercial objectives

The Crown corporation has a key role in interpreting its mandate.

The deficiencies in corporate plans undermine Crown corporation accountability.

with its public policy objectives, and the trade-offs required to achieve that balance. For example, a corporation may need to strike a balance between services that are needed but will not produce profit and services that are targeted more commercially and generate profit. The corporation also needs to consider how it can contribute to government priorities and initiatives while still ensuring that its activities are consistent with its mandate. It must address all of these issues in a corporate plan that the *FAA* requires it to produce. Government approval of that plan is required for Crown corporations under Part X of the *FAA*. The corporate plan is the cornerstone of the control and accountability framework for Crown corporations. Where the government wishes to provide specific direction to a corporation, it may do so by directive powers under the *FAA*, subject to certain statutory limitations.

18.92 The government is required to review the corporate plan before approving it in order to ensure that each Crown corporation's strategy maximizes the achievement of its mandate. We expected that the government's review and challenge would be rigorous, asking questions like the following:

- Has the corporation properly interpreted its mandate?
- Are the corporation's objectives, strategies and targets appropriate and do its performance indicators provide a strong basis for holding it to account?
- Are the trade-offs the corporation has made between its commercial objectives and its public policy objectives reasonable?
- Do its performance targets sufficiently "stretch" the corporation?
- Has the plan taken government priorities into account?
- Is the corporation capitalized appropriately, and are targets for dividends and return on equity appropriate?
- Has the corporation met its past performance targets?
- Is there a need to assess whether the corporation's mandate is still relevant?

Many deficient corporate plans are approved, and the government has limited capacity to challenge them

18.93 Our special examinations have found that there are significant deficiencies in some 38 percent of government-approved corporate plans, and less serious problems in a further 28 percent. Problems include any or all of the following:

- absence of long-term plans;
- unclear or non-existent corporate objectives, targets, goals and business strategies, as well as weak action plans; and
- little information by which to judge whether the corporation is achieving its objectives.

18.94 These weaknesses undermine the corporate plan as a basis for ensuring that performance and accountability are maximized and the government's objectives taken into account. They also indicate that the government's process for approving corporate plans is deficient in challenging Crown corporations to achieve optimal performance.

18.95 Crown corporation chairs and CEOs advised us that the government gave them little or no feedback on their corporate plans. They commented, "It was not always clear what the shareholder expected from its Crown corporations....It was too often a one-way street, with Crown corporations always feeding the system about what they were doing, but not hearing back from the shareholder about what they ought to be doing." The Public Policy Forum's 1998 report echoed

that conclusion, noting, "There is little discussion about these corporate plans, and the plans themselves become more ritualistic than real in addressing the challenges and choices facing Crown corporations."

18.96 To determine why these problems exist, we looked at whether the government (responsible minister, Treasury Board and Department of Finance) has the capacity for rigorous review and challenge of corporate plans as a basis for their approval.

18.97 Minister's review. The responsible minister provides the first government review of a corporate plan. We found that many corporations receive little or no feedback on their corporate plan from their responsible minister. Yet Treasury Board guidelines say that the annual submission of the plan is meant to be a regular medium for the board and the responsible minister to clarify their respective appreciation of the corporation's objectives. Generally, ministers have not responded formally to the corporate plan with an indication of areas of agreement as well as differences. The lack of formal communication is less troublesome when there is ongoing discussion between the minister and the Crown corporation. Half of the corporations we examined had a regular ongoing relationship with the minister. However, the other half saw their minister rarely, if ever, even when they requested a meeting and even when there were long-standing, unresolved issues.

18.98 Crown corporations themselves could do more to be aware of the government's concerns and priorities. For example, they could strengthen contacts with deputy ministers, ministerial staff or other officials to seek a better understanding of the government's objectives.

18.99 The government could also do more. The government itself has acknowledged the need to improve communication. Government policy positions developed in 1982 stated:

> To improve communication, the government will institutionalize the concept of an annual shareholder's meeting. Annually, each Minister as trustee owner, will meet with boards of directors to formally review corporate performance and to communicate specific government objectives to the board. This will not impede informal communication between the appropriate Minister and the corporation, but will underline the Minister's responsibility to ensure that the chairman and board of directors of the corporation are kept fully informed of government objectives and that the board's accountability to the government is maintained (Treasury Board of Canada, Policy Statement, 30 June 1982).

Many Crown corporations receive little or no feedback on their corporate plans from their responsible minister.

18.100 To properly exercise his or her responsibilities for a Crown corporation, the responsible minister must be able to obtain and rely on the related department's advice. Government policy positions in 1982 also stated:

> To enhance its shareholder capability the government will improve or establish, where appropriate, machinery to assist Ministers with primary responsibility for wholly owned corporations. What is needed is...the establishment of effective support for Ministers...to provide needed direction, control and accountability....The government will seek to ensure that appropriate procedures and mechanisms exist to co-ordinate review and approval of corporate submissions, in order that the government might respond to such submissions in a thorough and timely manner....Specialized units have been, or now will be, established to assist Ministers in the performance of trustee shareholder or proprietor duties. Such units will have a direct reporting link to the Minister and his or her Deputy Minister. These arrangements will be developed to ensure that effective communication

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between appropriate Ministers and corporate boards is maintained or enhanced (Treasury Board of Canada, Policy Statement, 30 June 1982).

18.101 We found that many departments lack the capacity to support ministers in their responsibilities for Crown corporations. Policy groups in departments have played only a limited role, for various reasons. In some cases, the activities of the department and those of the corporation share little or no common ground. Some Crown corporations reported that departments lack knowledge about the commercial dimension of Crown corporations.

Review by the Treasury Board and the Department of Finance is key to approving corporate plans.

18.102 Portfolio management represents the government's most recent effort to increase departmental capacity in this area. The minister is asked to ensure that all organizations under his or her authority work together to support the minister and the government's policies and programs. The Privy Council Office's Advice to Ministers on Portfolio Management stresses that portfolio management must continue to respect the arm's-length relationship between a Crown corporation and its responsible minister, the corporation's purpose as an instrument of public policy, and in some cases, the ability of the corporation to compete in the marketplace.

18.103 We found that portfolio management groups have generally not been active in supporting the ministers' challenge and review of corporate plans. Only one of the portfolio management groups has advised the minister on whether or not to approve corporate plans.

18.104 Portfolio management groups need to be sensitive to and respect the independence and autonomy of the board of directors in overseeing the management of Crown corporations. Their comments on corporate plans need to be at a strategic level.

18.105 At the same time, we saw some good practices that could be applied more broadly, as Exhibit 18.3 shows.

18.106 Review by Treasury Board and Department of Finance. After reviewing the corporate plan, the minister recommends it to the Treasury Board for approval; the Department of Finance also reviews it, if necessary. The Treasury Board looks at the strategic direction of each Crown corporation and the financial decisions or recommendations proposed by the responsible minister. It also approves the capital budget, certain transactions, and for most corporations, the operating budget. The Minister of Finance is responsible for the terms and conditions of borrowing plans and for directing that any surplus money held by a corporation be paid into the Consolidated Revenue Fund, with the concurrence of the responsible minister and the Governor in Council.

18.107 We found that some Treasury Board Secretariat analysts have challenged Crown corporations to set more demanding objectives and targets, and this has produced better plans. Generally, however, Crown corporations

Exhibit 18.3

Good Practices From Portfolio Management Groups

- **Some have regular meetings of the deputy minister and chief executive officers (CEOs), and the minister and chairs or CEOs, to discuss common issues and objectives.**
- **One minister wrote letters to a corporation about government priorities.**
- **One portfolio management group reviewed draft corporate plans, gave comments to the corporations and advised the minister on whether to recommend approval of the corporate plans. This group is considering the possibility of introducing a written response to corporate plans from the minister and an appointment letter to newly appointed chairs, indicating the government's priorities.**

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report that Treasury Board Secretariat analysts often pay too little attention to major strategic issues and too much to minor issues related to funding. Crown corporations also report that some Secretariat analysts have lacked an understanding of the corporation and the commercial environment in which it operates, and did not know how to read financial statements. We noted that a number of the analysts are at junior levels and many have had no previous experience with Crown corporations. Treasury Board officials advise that resource reductions due to Program Review, and a less focussed specialization in Crown corporations, may have contributed to this situation. While the Treasury Board and the Department of Finance have promoted a team approach, it is not clear which one is assessing the capital structure of the large financial corporations; neither undertakes that role systematically. In light of the structural changes within the Treasury Board Secretariat and Finance and the introduction of portfolio management, there is a need to ensure that all the government players understand their respective roles and responsibilities in reviewing and challenging corporate plans.

18.108 Crown corporations should be more proactive in finding ways to obtain information on government priorities and the government's response to their corporate plans.

18.109 To align expectations, each corporation and the responsible minister should reach an understanding on the most effective ways to outline priorities, provide feedback and reach consensus on corporate plan submissions and to maintain ongoing contact between them.

18.110 The government should strengthen its capacity to ensure that its approval of corporate plans is based on a rigorous challenge and review. It should strengthen departmental capacity to support ministers in their responsibilities for Crown corporations, and should ensure that all government players understand their respective roles and responsibilities in approving corporate plans.

Need for a more systematic review of corporation mandates

18.111 Periodically, there is a need to consider whether the mandate of a Crown corporation is still relevant. We found that in reviewing corporate plans, Treasury Board Secretariat analysts have sometimes commented on this. In other cases a change in government or minister, a significant change in the economy, or a Crown corporation's request for a legislative change can prompt a review of mandate relevance. Boards of directors clearly have an interest in mandate relevance because the mandate affects the choice of strategic direction and the development of the corporate plan. In all cases, the mandate review is a fundamental assessment of the continuing relevance of a Crown corporation's role. Such reviews generally go well beyond the scope of the annual corporate plan and are vital for ensuring that the corporation remains a cost-effective instrument of public policy.

Periodically, there is a need to consider whether the mandate is still relevant.

18.112 A decision to proceed with a mandate review needs to be based on such factors as an ongoing assessment of changes in the operating environment; an expressed need to make changes; a request by the corporation for a mandate review or for legislative amendments that affect the corporation's mandate; or an unresolved conflict related to the mandate that is holding up the shareholder's approval of the corporate plan.

18.113 We expected to find that mandate reviews are carried out regularly, reported to all parties in the accountability framework, and engage all parties concerned, including Parliament. What we found however, is that only two

corporations are required by their respective enabling legislation to undergo periodic mandate reviews.

18.114 We found that mandate reviews have been carried out by a corporation or the responsible minister's department on a generally ad hoc basis. Those done by the corporation were not always brought to the attention of the Treasury Board, the minister, or Parliament; nor did they engage all of the parties concerned, including Parliament, or address all of the relevant issues. Mandate reviews led by the minister, and supported by outside expertise as necessary, have a better record of engaging all parties and bringing out issues that may not be identified in a review conducted by the corporation itself. We note that a legislative provision for mandate review ensured that it was carried out when otherwise it might not have been.

18.115 We noted that some parliamentary committees have held hearings on the relevance of Crown corporation mandates. In one case, a parliamentary committee had a major impact on the corporation's move toward providing more service to a group that is a government priority. Generally, however, Parliament has little direct involvement with Crown corporations. It could take more opportunity to meet with Crown corporations and have them account for their results.

18.116 The government could consider the following guidelines for conducting mandate reviews:

- Each review assesses the current validity of the mandate, the continuing need for the corporation, and its record of cost-effective performance in meeting the needs implicit in the mandate.

- Mandate reviews are led by the minister and supported by outside expertise as necessary.

- The corporation provides input to the minister-led review, but does not conduct it or contract a third party to undertake it.

- The minister, in consultation with the corporation and central agencies, determines the terms of reference for the review with a focus on the critical elements of the mandate. It may be appropriate to limit the scope of some reviews to particular aspects of the mandate.

- Any third party contracted to conduct the review consults extensively with all parties concerned, inside and outside government.

- The results of mandate reviews are shared with all parties in the accountability framework — corporate management, the board, Treasury Board, the Department of Finance, the responsible minister and Parliament.

- Parliament conducts hearings on the results of mandate reviews, as appropriate.

18.117 The government should systematically consider, at least every 10 years, whether a review of each Crown corporation's mandate is warranted. This should be triggered by regulation or some other mechanism. The government should develop guidelines for conducting mandate reviews, and should ensure that the results of the mandate reviews are transparent and reported to all parties in the accountability framework.

Governance Protocol Between Ministers and Crown Corporations

18.118 In previous sections of this chapter we have cited the need for dialogue to reach an understanding between each Crown corporation and the responsible minister on the implementation of key aspects of governance, including:

- how the board of directors will be involved in the appointment of the board, the chair and the CEO;

- how the government will communicate any issues it wants a Crown corporation to take into account in its corporate plan;

- mechanisms for ministerial feedback on the corporate plan; and

- procedures for handling ad hoc issues and maintaining ongoing contact between ministers and corporations.

18.119 In addition, the dialogue could cover elements such as:

- expectations for performance monitoring;

- performance evaluations of boards and CEOs and their remuneration; and

- potential conflicts of interest.

18.120 Each minister's situation is unique, and strategies need to reflect the minister's needs and demands as well as the needs of the corporation. Each time there is a change of minister or a new chair is to be appointed, the agreement would be reconsidered and reviewed. The key to success for both parties would be managing expectations. As a means of confirming the agreement, the chair of the corporation could record his or her understanding of the agreement in writing and the minister could outline the agreement in a letter upon the chair's appointment. The agreement thus documented would constitute a governance protocol. Prospective new board members would be given a copy of the protocol. A protocol that gave the board a meaningful role would help attract strong board members, and this would serve the interests of both the corporation and the government.

18.121 Each Crown corporation and the responsible minister should reach a common understanding on the implementation of key aspects of governance, and they should record that understanding.

Conclusion

18.122 The management of Crown corporations has improved in the 15 years since the *Financial Administration Act* was amended to introduce a strengthened Crown corporation accountability regime. The results of our special examinations bear this out. Nevertheless, further improvement is needed in some important areas of Crown corporation management like strategic and corporate planning and the measurement and reporting of performance.

18.123 Our findings on the process for appointing boards of directors converge with those of other studies to confirm that there is a need for the federal government to revisit and strengthen the process. Boards of directors are responsible for the affairs of the corporation. Yet boards lack essential skills and capabilities that are required to effectively carry out their role. The government needs to meaningfully involve boards in their renewal. Boards and the government need to outline their respective skill and capability requirements, and the government needs to act on them. Boards of directors also need to take a more active role in their chairs' selection.

A governance protocol that gave the board a meaningful role would help attract strong board members.

18.124 The government needs to improve the timeliness of its appointment decisions and maintain its progress in extending the average length of time served by qualified directors. This will ensure a nucleus of seasoned directors who can provide institutional knowledge and experience.

18.125 We found that accountability of the chief executive officer to the board is best reinforced when the board takes the lead role in the CEO's selection, with the government providing input and making the final decision. A transition strategy may be needed to reach this goal for some boards that do not yet have the capacity to lead the selection process.

18.126 The effectiveness of audit committees is assuming ever-greater importance. We found that the practices of audit committees need to be strengthened if they are to more effectively discharge their key roles and responsibilities in Crown corporation governance and the financial reporting process. A strengthened audit committee will mean a stronger board of directors.

18.127 The corporate plan is the cornerstone of the control and accountability framework for Crown corporations. We found deficiencies in many government-approved corporate plans, and a limited capacity in government to review and challenge those plans as a basis for their approval. These weaknesses undermine the corporate plan as a basis for ensuring that performance and accountability are optimized and that the government's priorities have been addressed.

18.128 Periodically, there is a need to verify whether the mandate of a Crown corporation is still relevant. Mandate reviews are the standard tool for this. They have proved useful in realigning Crown corporation mandates. We found, however, that the need for mandate reviews needs to be questioned more regularly, the results more widely reported, and the reviews led by the government, with the involvement of Parliament.

18.129 There is a need for dialogue and consensus between each Crown corporation and the responsible minister on how each party will be engaged in implementing key aspects of governance. The board of directors of each Crown corporation and the responsible minister need to document their shared understanding of how these key aspects of governance will be implemented, thereby creating a governance protocol.

18.130 We plan to follow up within two years on the recommendations we have made in this chapter, including those on the quality and composition of boards of directors. We will also review the progress made on the recommendations as we conduct our annual audits and special examinations in individual Crown corporations.

Privy Council Office's response: *Good corporate governance is essential if a Crown corporation is to fulfil its mandate. The government has made strides in a number of corporate governance areas, including improving reappointment statistics (64 percent of incumbents eligible for reappointment are reappointed as directors for a second or third term) and ensuring that appointments reflect Canada's diversity.*

Improved and increased communication among all the interested partners will be a critical factor in addressing concerns identified in the study and in responding to the recommendations put forward. Measures will be examined to address areas needing improvement and to ultimately strengthen corporate governance in Crown corporations.

It is paramount that appointments to Crown corporations result in strong boards of directors and that the appointment process for Crown corporations is inclusive of all interested parties, bearing in mind that appointments to boards of directors of Crown corporations, including those of the chair and the chief executive officer, remain at the discretion of the government.

Crown corporations' responses: It is not practical to obtain the responses of 41 Crown corporations to the recommendations that apply to them directly. However, we did discuss our findings and recommendations with the chairs and CEOs of 10 Crown corporations. Generally, they supported the main messages of the chapter and, for the most part, agreed with the recommendations directed specifically at Crown corporations.

About the Audit

Objectives

The audit sought to assess how well three key governance features of the *Financial Administration Act* (*FAA*) are functioning in Crown corporations. These include the appointment process for directors, CEOs and chairs; the capacity of the government to review and challenge corporate plans and ensure mandate relevance; and the composition, roles and responsibilities and performance of audit committees.

In addition, we wanted to provide a summary of the results of the three cycles of special examinations in Crown corporations.

Scope

The audit scope included a review of the key responsibility and accountability provisions of Part X of the *FAA* and parallel provisions in the enabling legislation of Crown corporations exempted from Part X. We examined the practices of these Crown corporations and the various shareholder players to support the process for appointing directors, chief executive officers (CEOs) and chairs, to review and challenge corporate plans, and to ensure mandate relevance.

We compared these practices with standards and practices of state-owned enterprises in industrialized countries. In addition, we interviewed chairs and CEOs, and examined appointment data from 15 diverse Crown corporations. We also examined the composition, roles and performance of audit committees in the same sample. We further examined recent chair, CEO and director appointments in eight corporations. We used the results of other research, studies, audits and roundtables to provide supporting evidence for our findings. All recommendations were made within the parameters of the existing *FAA* accountability and control framework, and respected the Governor-in-Council authority for appointments.

The chapter also provides a summary of the results of the third cycle of special examinations. Special examinations are a form of value-for-money audit carried out in Crown corporations.

Criteria

The following general audit criteria were applied. We expected that in order to protect the shareholder's interest, to ensure that Crown corporations achieve their public policy objectives effectively and efficiently, and to optimize their commercial objectives:

- There should be timely appointments of qualified board chairs, CEOs and board directors that meet the requirements of the government and the corporation and strengthen the accountability relationships among the board, the CEO and the government.
- Audit committees should be constituted with appropriate skills and experience, carry out necessary roles and responsibilities, and perform their duties effectively, as measured against best practices.
- The government should conduct a robust review and challenge of a corporation's corporate plan, as the basis for the plan's approval.
- There should be assurance that the mandate of each corporation, including its public policy and financial objectives, continues to be relevant.

Audit Team

Assistant Auditor General: John Wiersema
Principal: Brian Strom
Director: Rona Shaffran

Denis Scott
Marc Seguin
Sophia Khan

For information, please contact Rona Shaffran.

Appendix A

List of Crown Corporations by Responsible Minister

Minister Responsible for	Crown Corporation
Agriculture and Agri-Food Canada	Canadian Dairy Commission Farm Credit Corporation
Canadian Heritage	Canada Council* Canadian Broadcasting Corporation* Canadian Film Development Corporation* Canadian Museum of Civilisation Canadian Museum of Nature Canadian Race Relations Foundation* National Arts Centre Corporation* National Capital Commission National Gallery of Canada National Museum of Science and Technology Corporation
Department of Finance	Bank of Canada* Canada Deposit Insurance Corporation Canada Development Investment Corporation CPP Investment Board* Petro-Canada Limited
Fisheries and Oceans	Freshwater Fish Marketing Corporation
Foreign Affairs	International Development Research Centre*
International Trade	Canadian Commercial Corporation Export Development Corporation
Industry Canada	Business Development Bank of Canada Enterprise Cape Breton Corporation Standards Council of Canada
Natural Resources Canada	Atomic Energy of Canada Limited Cape Breton Development Corporation
Public Works and Government Services Canada	Canada Lands Company Limited Canada Mortgage and Housing Corporation Canada Post Corporation Defence Construction (1951) Limited Queens Quay West Land Corporation Royal Canadian Mint
Transport Canada	Atlantic Pilotage Authority Federal Bridge Corporation Ltd., The Great Lakes Pilotage Authority Laurentian Pilotage Authority Marine Atlantic Inc. Pacific Pilotage Authority Ridley Terminals Inc. VIA Rail Canada Inc.
Treasury Board	Public Sector Pension Investment Board*

* Exempt from the accountability framework of the *Financial Administration Act*.

Appendix B

Roles and Responsibilities Under the *Financial Administration Act*

	Crown Corporation		Shareholder			
	Chief Executive Officer (CEO)/ Management	Board	Responsible Minister	Treasury Board, Finance and Privy Council Office (PCO)	Governor in Council	Parliament
Creation, Acquisition, Disposal and Dissolution						
Parents			Recommends	Review		Approves
Subsidiaries			Recommends	Review	Approves	
Appointments						
CEO and Chair		Provides advice	Consults		Appoints	
Other Directors			Appoints		Approves	
Officers of Corporation	Recommends	Appoints				
Remuneration and Other Benefits for Chairs, CEOs and Directors						
Remuneration and Benefits		Approves benefits other than remuneration and recommends CEO performance pay			Approves the rate of remuneration and CEO performance pay	
Directives and Regulations						
Directives			Recommends and tables copy with Parliament		Approves	Receives
Regulations		Requests	Recommends	Recommend	Approves	
Plans, Budgets and Reports						
Corporate Plan	Prepares	Approves submission to Minister	Receives and recommends	Review and recommend	Approves	
Operating Budget	Prepares	Approves submission to Minister	Receives and recommends	Approve		
Capital Budget	Prepares	Approves submission to Minister	Receives and recommends	Approve		

	Crown Corporation		Shareholder			
	Chief Executive Officer (CEO)/ Management	Board	Responsible Minister	Treasury Board, Finance and Privy Council Office (PCO)	Governor in Council	Parliament
Plans, Budgets and Reports (cont'd)						
Summary of Corporate Plan/Budgets	Prepares	Approves submission to Minister	Approves and tables copy with Parliament			Receives
Annual Report	Prepares	Approves and submits to Minister	Receives and tables copy with Parliament	Receive		Receives
Audits						
Internal Audit	Manages	Approves audit plans and receives audit reports				
Annual Auditor's Report	Receives	Receives	Receives		May require other reports	
Special Examination Report		Receives	May receive			May receive

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20 Victoria Street
Toronto, Ontario M5C 2N8
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Toll Free: 1-800-387-2689
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Appendix C

General Information on Special Examinations and Overview of Results

What are special examinations?

A special examination is a type of value-for-money audit of a Crown corporation. It serves to provide an independent opinion to the board of directors on whether the corporation's financial and management control and information systems and management practices have been maintained so as to provide reasonable assurance that:

- the assets of the corporation have been safeguarded and controlled;
- the financial, human and physical resources of the corporation have been managed economically and efficiently; and
- the operations of the corporation have been carried out effectively.

Examining all systems and practices in detail is impractical and costly. Therefore, based on a thorough understanding of the corporation and its operating environment, and on a risk analysis, the examination concentrates on areas of the corporation where any deficiencies that might exist could be significant.

All parent Crown corporations named in Schedule III of Part X of the *Financial Administration Act (FAA)*, and their wholly owned subsidiaries, are subject to special examinations. Crown corporations undergo a special examination every five years. The first five-year cycle of special examinations was conducted between 1984 and 1990, and the second between 1990 and 1996. The third cycle of examinations commenced in 1996 and will be completed by 2001.

How many Crown corporations are subject to special examinations?

Thirty-nine Crown corporations were subject to a special examination during the third cycle. The Office has carried out 29 of 31 examinations to date (two as joint examiner), while private sector practitioners have conducted 8. The results discussed hereunder are based only on the examinations carried out by the Office of the Auditor General.

Our special examination findings indicate that management of Crown corporations is improving. Nevertheless, there are important areas that continue to require further improvement.

Types of opinions reported

The following table sets out the types of opinions reported in all three cycles of special examinations (SEs). A "clean opinion" indicates that no significant deficiencies were reported. "Significant deficiencies" indicate one or more instances where there wasn't reasonable assurance that assets were being safeguarded and controlled, resources managed efficiently and economically, or operations carried out effectively.

Type of Opinion	1st Cycle - 26 SEs	2nd Cycle - 32 SEs	3rd Cycle - 29 SEs
Clean opinion	23%	22%	52%
Significant deficiencies	77%	78%	48%

When comparing results of the third cycle to those of previous cycles, we see a significant improvement in the proportion of special examinations that had clean opinions.

To whom were special examinations reported?

When a special examination contains information that, in the examiner's opinion, should be brought to the attention of the appropriate minister or Parliament, the examiner may do so. (This provision of the *FAA* does not apply to Crown

corporations named in Part 2 of Schedule III of the Act and most exempt Crown corporations.) Reporting beyond the board of directors is usually done when the significant deficiency is beyond the corporation's ability to address on its own, or when significant deficiencies noted in a previous special examination have not been adequately addressed, or when several significant deficiencies have been identified in a corporation's systems and practices. Otherwise, the report is provided to the board of directors only. The following table shows the proportions of special examinations reported to the board and beyond.

Special examinations reported to	1st Cycle	2nd Cycle	3rd Cycle
Board of directors only	81%	63%	76%
Minister	11%	37%	24%
Parliament	8%	-	-

The reduction in the number of reports brought to the attention of the appropriate minister in the third cycle is directly related to the reduction in the number with significant deficiencies; four reports with significant deficiencies that went to the appropriate minister in the second cycle, had clean opinions in the third cycle. The fact remains, however, that one quarter of Crown corporations had significant deficiencies that the examiner felt should be brought to the attention of the appropriate minister.

What significant deficiencies were reported?

The following tables identify the systems and practices where significant deficiencies were found (one significant deficiency may affect more than one system). While only significant deficiencies were identified in first and second cycle special examination reports, third cycle reports also included other important deficiencies that the examiner thought should be reported to the board. For the third cycle, the table identifies the systems and practices where significant deficiencies were found, and gives an additional column combining them with other deficiencies found in the third cycle.

Systems and Practices (Areas)	Percentage of Crown corporations with significant deficiencies in identified areas			Percentage of Crown corporations with both significant and other deficiencies
	1st Cycle	2nd Cycle	3rd Cycle	3rd Cycle
Corporate and strategic planning	50	53	38	66
Performance measurement and reporting	46	53	24	76
Operations	65	44	17	66
Human resources management	42	28	10	62
Asset and facilities management	46	25	7	14
Risk management	15	9	7	14
Environment	8	9	7	21
Marketing	27	22	3	31

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Percentage of Crown corporations with significant deficiencies in corporate and strategic planning and/or performance measurement and reporting			
			Includes other deficiencies
1st Cycle	2nd Cycle	3rd Cycle	3rd Cycle
62	78	38	90

The reduction in the systems and practices with significant deficiencies in the third cycle is directly related to the overall reduction in the number of special examinations with significant deficiencies. However, it is still of concern that 38 percent of Crown corporations had significant deficiencies related to corporate and strategic planning and performance measurement and reporting (90 percent had significant and other deficiencies combined). This indicates that these corporations do not:

- have well-articulated corporate visions, values and goals;
- have clearly expressed strategies or action plans to achieve their mission and vision;
- know the extent to which they are achieving their objectives; or
- report adequately on these objectives and strategies to Parliament and government.

Environmental and sustainable development issues in Crown corporations

Of the 29 special examinations of Crown corporations completed so far in the third cycle, 20 included the management of environment and sustainable development issues. Those issues were excluded from the examinations of the 9 other corporations after our survey found no potentially significant environmental risks. Two of the 20 special examinations reported significant deficiencies related to the corporations' systems and practices for the environment and sustainable development. Neither corporation had an environmental management system (a formal environmental policy, environmental objectives, measurable targets, and a process to ensure that environmental and sustainable development considerations are taken into account in decision making).

Some other areas for improvement were identified. These included the need for:

- a more comprehensive environmental management system (for example, a corporation might need to improve information, or to formalize and document existing procedures);
- improved measurement and reporting of environmental performance;
- more training in environmental management; and
- a policy on environmental considerations in the awarding of offshore contracts.

Percentage of Crown corporations with significant deficiencies in corporate and strategic planning and/or performance measurement and reporting			
			Includes other deficiencies
1st Cycle	2nd Cycle	3rd Cycle	3rd Cycle
62	78	38	90

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- improved measurement and reporting of environmental performance;
- more training in environmental management; and
- a policy on environmental considerations in the awarding of offshore contracts.

Appendix D

Best Practices Applicable to Federal Crown Corporation Audit Committees

In this appendix, we present a comprehensive list of suggested best practices that are applicable to federal Crown corporations and are complementary to the statutory requirements of audit committees under Part X of the *Financial Administration Act*. These best practices were taken from recent studies and publications in Canada and the U.S., including the *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*, sponsored by the New York Stock Exchange and the National Association of Securities Dealers (1999), as well as various accounting and auditing publications.

We do not suggest that this template of best practices applies equally to all audit committees. Each audit committee should develop and observe guidelines suited to itself and its corporation. Some of these responsibilities may also be assigned to other board committees. However, as part of the audit committee's periodic self-assessment, it should ensure that key oversight responsibilities outlined in the best practices are assumed by it or another board committee.

Audit Committee Best Practices

(Those in **bold** were selected for comparison with current Crown corporation practices, as described in the chapter.)

Audit Committee Responsibilities

The audit committee should:

- ensure oversight of compliance matters by monitoring the corporation's compliance with applicable laws and regulations.
- **ensure financial oversight by:**
  - **critically reviewing** the operational and capital budgets, **interim and annual financial statements, the auditor's report and the management discussion and analysis section of the annual report**; and
  - reviewing the external auditor's audit plans and **actively soliciting his/her judgments about the quality, not just the acceptability, of the corporation's accounting principles as applied in its financial reporting. This discussion should include such issues as the clarity of financial disclosures and the degree of aggressiveness or conservatism of the corporation's accounting principles and estimates**.
- **ensure oversight of corporate books, records, financial and management control and information systems and management practices by:**
  - **reviewing the special examination plan and report prepared by the external examiner;**
  - **actively soliciting information about significant risks and exposures and reviewing the adequacy of internal controls to manage those risks;**
  - **reviewing the integrity and effectiveness of the management information systems;**
  - **reviewing internal audit plans and reports and management's subsequent actions; and**
  - **reviewing significant findings and recommendations made by the external auditor and follow up on management's subsequent actions.**

- confirm the external auditor's independence through the receipt of a formal written statement from the external auditor and through subsequent dialogue about any issues that may impact the objectivity and independence of the auditor.
- **ensure ethical oversight through the annual review of management's compliance with the corporate code of conduct.**
- **actively solicit all sensitive information (for example, senior management expenses, significant litigation, non-compliance with laws and regulations, misuse of corporate assets, illegal activities).**

The audit committee should, where warranted, advise the board of directors about any of these matters.

Membership and Competencies

The audit committee should be composed of at least three directors, the majority of whom should not be officers or employees of the corporation. Audit committee members must have a significant degree of commitment to the corporation that they take adequate time for meeting preparation, near-perfect meeting attendance, and ongoing education about the corporation's business and environment and topical issues.

Good governance dictates that the board be composed of individuals with certain personal characteristics such as integrity, strategic thinking, and the ability to ask probing questions. Ideally, audit committee members would be the most qualified and experienced directors on the board.

Although a variety of skills and experience is beneficial to an effective and balanced audit committee, all members should be financially literate and at least one member should have accounting or related financial management expertise. Financial "literacy" signifies the ability to read and understand fundamental financial statements, including a balance sheet, income statement and cash flow statement, and the ability to ask probing questions about the corporation's financial risks and accounting. "Expertise" signifies past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background that results in the individual's financial sophistication (such as CEO or other senior officer with financial oversight responsibilities).

Operating Procedures

Terms of Reference. Audit Committees should have clear, written terms of reference and operating procedures that specify the scope of the committee's responsibilities, and how it carries out those responsibilities, including structure, processes, and membership requirements. This charter should be approved and reassessed periodically by the board of directors.

Authority. The audit committee should have explicit authority to investigate any matters within its terms of reference, should be provided with the resources it needs, and should have full access to information and the organization's personnel. The committee should also be able to obtain independent professional advice.

Member Orientation. The audit committee should consider training and education programs for its members to ensure that they have current knowledge of the following:

- the committee's responsibilities and the methods of discharging them;
- the roles of the internal and external auditors;
- the corporation's business, including products, systems, risks and opportunities; and
- basic elements of technical areas such as accounting principles and policies, internal control systems, and auditing.

Meetings. The frequency of audit committee meetings should be tailored to the responsibilities assigned, but should be at least quarterly. The audit committee agendas are set with sufficient input from the chair of the

committee, the CEO, the chief financial officer and the internal and external auditors. Detailed minutes of the meetings should be prepared. The external auditor should be invited to every meeting. **The audit committee should also periodically meet with management, the external auditor and the director of internal auditing in separate private sessions.**

Reporting and Self-Assessment. The audit committee should periodically report the results of its activities to the board of directors. Its charter should be disclosed at least triennially in the corporation's annual report. The committee should also provide a general disclosure letter in the corporation's annual report stating whether the audit committee has satisfied its responsibilities during the prior year in compliance with its charter. The disclosure should also state that the audit committee:

- has reviewed the financial statements with management and has discussed the quality of the accounting principles and significant judgements;
- has discussed the audited financial statements, accounting principles and significant judgements with the external auditor;
- has discussed the information provided by management and the external auditor; and
- believes, in reliance on the review and discussions with management and the auditors, that the corporation's financial statements are fairly presented in conformity with generally accepted accounting principles in all material respects.

The audit committee should periodically assess its effectiveness and the adequacy of its mandate, and its chair should also periodically assess the performance of individual committee members.

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